Audit Review (RN) July 17, 1964

Tax Counsel (PM)

"L"

In reply to your memo of May 13, it is our opinion that the proper measure of tax on the transfer of business assets by the above taxpayer is $40,000.

The taxpayer, an individual proprietor, sold an undivided one-half interest in his machinery and equipment to a Mr. "K" for $20,000 cash. On the same day, and pursuant to the same agreement, both the taxpayer and Mr. "K" transferred their interests in the machinery and equipment to a newly formed corporation for two promissory notes in the amount of $20,000 each. Subsequently the taxpayer and Mr. "K" together invested $10,000 cash in the corporation in exchange for equal amounts of capital stock.

The auditor treated the sale to Mr. "K" and the sale to the corporation as an integrated transaction, setting up a total sale by the taxpayer in the amount of $40,000 ($20,000 cash and $20,000 notes receivable). Under the particular circumstances, we believe this treatment of the transaction was correct. It was intended from the beginning that the tangible assets held by the taxpayer as a sole proprietor would become the tangible assets of the new corporation. The transfers which brought about this result were, in fact, the subject matter of a single agreement between the parties. In our opinion, therefore, Mr. "K" is properly regarded as a mere conduit of title, absent any legitimate business reason for the so-called step transaction.

PM:o'b [lb]